Economic Policy Review

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In the issue:

Tax Freedom Day is again the 29th of May
Inflation In 2007
NO to the Energy Holding!
Global Index of E-Government Development
The Government's Legislative Program
How healthcare is financed in Europe?

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Tax Freedom Day is again the 29th of May

Adriana Mladenova

According to the budget for 2008, this year the Tax Freedom Day will be on the 29th of May! This is the day when the people will stop working for the government and will start working for them. If the taxpayers were forced to give all their earnings to the government, until the revenues forecasted for the entire year to the budget are collected, than only after that date they could keep their income for themselves, than 29th of May would have been that date.

During 2007, according to calculations by the Institute for Market Economics, the Tax Freedom Day was also the 29th of May. Thus, although the flat tax was introduced on the income of physical persons – 10% and the reduced social security payments by three percentage points since 1st of October 2007, the people will not work less for the government this year. Only the fact that 2008 is a leap year saves us from celebrating the day of freedom one day later than last year – 30th of May.

The reason is that the redistribution foreseen by the budget increases, rather than to be reduced. These calculations do not include the expected over fulfillment of the state revenues, which we have witnessed in the last five consecutive years. This means that the government is taking from the taxpayer more than is required to cover for the planed expenses. Which anyway are too large. The funds collected are spent for the administration, subsidies to loss making activities such as the rail road transportation, providing state subsidies (for example to the agricultural producers), purchase of equipment for the military, paying pensions, implementation of social policies, subsidies to cultural events.

The tax burden measured as a percentage of the expected tax revenue from GNP is increasing in 2008. This means that there is a redistribution of the tax rates on different tax bases and sources of income, but as a whole the tax burden on the people is not reduced. According to the calculations, the government treasury will collect additional 301 million from increasing the excise tax on fuel, cigarettes and electricity and will lose 180 million from the introduction of the flat tax. As you can see the government is a net winner, which is different from the people which are the actual losers.

How could we celebrate the day of freedom earlier?

We believe that the Bulgarian economy would develop much faster if it follows the principals of freedom, entrepreneurship, and personal initiative, free and competitive market. These ideas are expressed by reducing the government intervention in the economy. The specific proposals by the IME include:

- Reduction of the largest tax at present – the social and health payments, equal to 33.5% of the income of the employed (on labor contracts, 3rd category labor).
- Introduction of real financial decentralization, where the mayors will have the

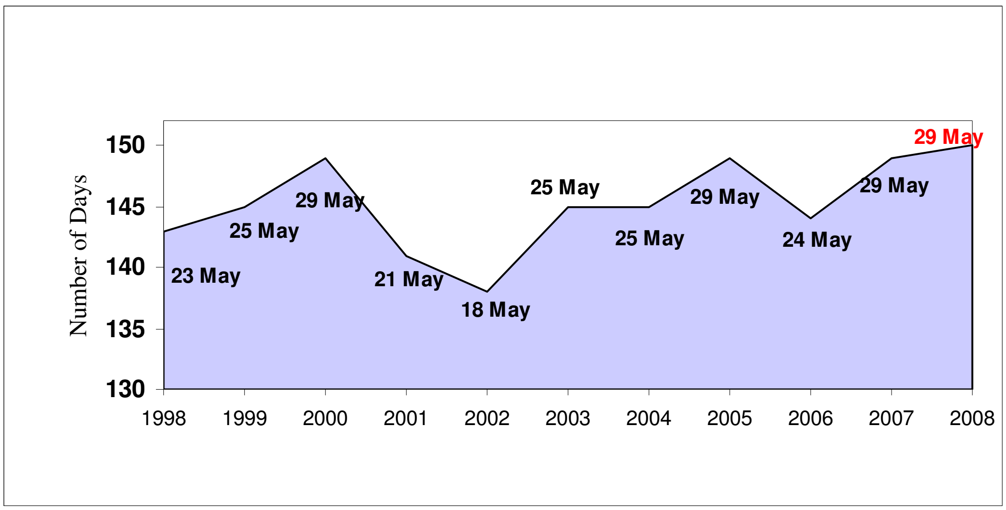
right not only to increase, but also to reduce the local taxes.

- Introduction of zero tax on reinvested profits, eliminating the tax on dividends and reducing the tax for one person merchants from 15% to 10%.

All these proposals must be combined with reductions of the expense side of the budget through privatization of state companies, optimization of the administration, reforms in the area of healthcare and social services – moving to a capital pension system and breaking of the monopoly of the health fund, introduction of private health funds and allowing for personal negotiations in the system. This will allow reducing the share of personal income for social security in personal accounts, while the expected pensions will be higher and the healthcare with better quality.

If all these steps are executed this will allow celebrating the day of freedom much earlier – possibly in April.

The day of freedom from government intervention in Bulgaria over the years



Source: IME

Inflation In 2007

Dimitar Chobanov

Recently the data about the consumer price index for December 2007 were published and that made it possible to analyze its development throughout the year. The growth of the prices during December 2007 compared to December 2006 is 12.5%, while the average annual inflation during 2007 is 8.4%, which is the highest value since the year 2000.

The main reason for the prices growth is the change of the money supply. It is due to various factors but the basic one is the currency board. This is a monetary regime where the new emission of money by the central bank is done only when there is a cover by the reserve currency – EURO. Thus the initiative must come from a participant on the market, while the central bank must when requested to exchange levs against EURO and vice versa according to a fixed rate. One of the conditions for successful functioning of the board is to have complete coverage of the money base with currency reserves. In Bulgaria with currency reserves is also covered the deposit of the government with "Emissions" department, which is playing the role of the currency board. This allows sterilizing part of the capital flow, which enter the economy, where the fund are put into deposit and do not multiply.

The strong positive balance of the financial account, which is greater than that of the current account, leads to increase in the official currency reserves and the money supply of the country. Together with that, the internal credit and deposit base are also increased, which means that more money is created than are in demand. The result is the increase of prices. Naturally this is not happening evenly, since the supply and demand of the various good and services also change.

An example of that are the food staff and the nonalcoholic beverages, which at the end of 2007 are with 21.1% higher prices than at the end of the previous year. The causes could be both on the side of the demand and the supply side. The higher incomes of the population, as a result of increased salaries and pensions, lead to higher demand, which on top of that is with low elasticity. On the other hand the weak harvest due to unfavorable climate conditions reduced the supply.

Another group where the prices have increased significantly is the services in restaurants and hotels (increase by 19.3%), as well as the transportation services (15%). We can expect in the middle term that the prices for services will grow faster than those of goods, since there the difference from the average levels in the European Union is significantly larger. While the prices of some goods are closer to those in the EU (for some other good they are already higher), with the services where the cost of labor is a higher percentage of the production costs and the end-user price, they are still significantly lower. Hence, the prices of services must grow with a higher rate during the next several years.

On the other hand the prices in the communication sector are falling slightly. The reason for that is the increased competition in mobile communications and suppliers of internet services, while in the postal services, the state monopoly is artificially maintained.

The competition on the supply side on some markets is still inefficient and this leads to higher prices. The government policy in that respect must be directed toward removal of the obstacles for entry of new players and reduction of the costs to comply with regulations. This is the way to increase production and competitiveness of the companies which operate in the country. The benefits of that will not only are for them, but for the consumers as well, which could have more goods and services.

The expectations for 2008 are related to continued growth of the money supply in the country, inflow of capitals and hence increasing prices. The average yearly inflation will probably be between 5 and 7%; here we exclude the possible unfavorable shocks like from the bad harvest as in 2007. The growth of the salaries and pensions will be faster than the growth of prices, but we should keep in mind that the fast growth of incomes increases the inflationary expectations and also leads to increase of the price levels.

NO to the Energy Holding!

Peter Ganev

This year looks like very interesting from the point of view of the changes in the Bulgarian energy sector. We are not talking here about the number of agreements which the state will sign, whether oil and gas pipelines will be passing through the territory of the country, will there be a tax on the pipes on question, or how the price of oil will change on the world markets. We are not talking about whether NPP "Kozloduy" will produce sufficient energy and whether there would be a regime on the electric supply. This which we expect to be in the centre of attention is the state policy itself with respect to the energy sector and possible tern toward consolidation of the sector.

After the acceptance of the Energy Strategy of Republic of Bulgaria in 2002, the Bulgarian energy sector could be characterized with the words: restructuring, privatization and liberalization. It is important to note, that this process is very slow and the energy sector continues to be ineffective and is fare from the understanding of the words **"competitive sector"**. The distribution of electric energy is already separated from production and is in private hands, however this does not change the fact that "**a huge part of the electric energy is produced by state own companies"**. The electric power grid is also owned by the state. The claim the there is already a free market for electric energy and almost any user could freely negotiate the price of his supply is arguable. It is clear that the National electric company (NEC) is buying enormous quantities of electric energy (including long term contracts for buying electric energy from TPP “Maritsa 1 and 2” and TPP “Maritsa 2”, as well as electric energy from renewable sources), which inevitably affects the market and the price. On the other hand even if the consumers negotiate freely with the distributors of electric energy or directly with the producers, the fact that these producers are state owned is sufficient for us to claim that the price is not determined entirely by the market conditions.

Actually, everything in the Bulgarian energy sector turns around one simple word – “competition”. The aim of the current state policy in the last few years (the same objective is followed by the EC as well) is to reach a high level of competition in the sector. The main question, however remains **how exactly to achieve this competition?!**

Until now the Bulgarian government considered that, to achieve competition in the sector, it is sufficient mainly to liberalize and to a lesser expend to privatize. Liberalization in this case meant artificial break up of the large government monopolies and creation of smaller but still state owned companies. The smaller companies in question are than privatized and pass into private hands. In other words the logic is approximately the following: “*it is nice to have competition and many players on the market, however if by chance there is a larger player than the rest then it must be state owned.”* Such logic however is twisted. It is based on the understanding that the state monopoly is something good, while the big business and the aspirations for growth and taking over market niches are something bad. The sector, however, offers the presence of large players and if this does not change we would never have a competitive energy sector. An interesting example with a similar sector is telecommunications. We all remember how this sector looked with the state monopoly and we could all see what happens now with just several big private players on the market. Would you say that the big business damaged the sector?! Or made it one of the most developed in the country?!

The understanding of the ways to achieve competition in the sector must be changed from “*let us first liberalize (break down the large state companies) and than eventually privatize”* to *“let us privatize immediately, than the liberalization (the restructuring of the existing structures and the entry of new players on the market) will happen by itself*”.

Apparently the probability that the government will change its approach to the energy sector during 2008 is very high. Unfortunately the variant reviewed above to achieve higher competitiveness in the sector may remain a low priority and to start the process of consolidation. Few days ago the Minister of economics and energy announced that “*the ministry is working on creation of an energy holding, which will combine the open cast mines at “Maritsa-East”, TES “Maritsa-2”, NPS “Kozloduy”, NEC and “Bulgargas”.”* The Minster also stated that this will be *“a significantly competitive structure”*. It is interesting to note that in all official documents of the country they talk about creation of a more competitive sector and nowhere is mentioned the creation of competitive structures. This structure practically will have no one to compete with! This is the vision for a “competitive sector”!

Apparently, the Bulgarian government has a quite mixed vision about the energy sector and as a result the misunderstanding of the term “competition”. The misunderstanding of competition was illustrated perfectly during July 2005 by the state arm responsible for those issues – The Commission for Protection of the Competition (CPC). On July 6th 2005 CPC allows the purchase by PAO “EEC Russia” of TES “Varna” JSC. The Russian company won that tender by offering a price which was double that offered by the next competitor (CEZ). On July 8th 2005, only two days later, CPC allowed the purchase by PAO “EEC Russia” of Ruse Central Heating Plant. The offered price was over four times higher than the next contender (CEZ). CPC however, placed a restriction which does not allow the execution of both deals. The deals in question are for over one billion levs, but according to CPC they would lead to establishing a predominant position, which will significantly limit the effective competition on the market. The Russian company was forced to choose which one of the two companies to acquire and as a result both deal failed.

When we remember these events the question arises: **if acquiring two companies with relatively small market share by a private company could limit competition and has negative effect on the market, how the consolidation of the largest companies in the sector and the formation of a very large state owned holding will help market competition?!**

Global Index of E-Government Development

Metodi V. Metodiev

In the last few years the topic of e-government and the readiness of the Bulgarian administration to utilize contemporary information and communication technology are on the agenda both in public speaking and in political rhetoric.

Up until now we have seen political will to work towards the introduction of the principles of e-government, but the practical results are fare from the expected, if we take into account the enormous amount of money (about 224 million from the state budget[1]), set aside for investment in technology and building human capacity.

Below, I would present the results and conclusions of the recent UN report about the index of e-government readiness on a global scale.

The index is based on the measurements, according to specific methodology, of three basic components:

1) **web based study of the status of the services offered** – this is an analysis of the practical functioning of the internet pages of separate government structures and the level of services offered. Whether there is information, if there is such, than whether the user could exchange information with the institution and finally whether it is possible to execute real time transactions;

2) **index of the existing and operating telecommunications infrastructure –** the second component analyzes the existing telecommunications infrastructure and how it is practically used to provide services based on e-government principles. The index consists of several sub-indexes: 1) people using internet per 100 persons; 2) computers per 100 persons; 3) mobile telephones per 100 persons; 4) access to telephone per 100 persons; 5) wide band connection per 100 persons.

Each one of these sub-indexes represents 20% of the total index.

3) **human capital –** this index represents the technological literacy of the population within the specific region under study;

In addition, the index uses one more measurement, which is called e-participation. It represents information about the degree of influence of society with respect to decision making by the government, through the internet pages of the institutions, various blogs, special forums etc.

The index of e-participation accesses the quality and usefulness of the information and services provided by the state, with the aim to include society in the process of policy formulation.

The methodology of studying the e-participation index includes evaluations based on the results obtained from three fundamental categories:

1) **E-information –** each institution provides information on its internet page about the structure, functions, policies, decisions, various reports, documents, contact information etc.;
2) **E-consultancy –** actual possibility for the people to communicate with the institutions by asking questions, entering documents and receiving responses, respectively;
3) **E-formulation of decisions –** the institutions take into account the proposals and recommendations submitted by the people and businesses and jointly formulate policies and decisions about specific cases

What are the results?

Practically the index study 20 services provided by the government to the people and businesses. The scope of the study includes 189 countries.

For 2008 the top places are taken by the Scandinavian countries. On first place is Sweden, on second is Denmark and on third - Norway. Bulgaria has moved two places forward and in 2008 it is at 43rd place. Ahead of Bulgaria are Poland, Ukraine, and Slovakia.

In the Eastern European region leading is Czech, followed by Hungary and Poland, while Bulgaria is sixth in the region.

From the global point of view, Bulgaria's place on the index is relatively acceptable (for the

[1] According to the calculations in the plan for implementing the strategy for electronic government.

moment) but when we take into account the amount of time and money spent on building the e-government, the assessment is changed to negative. Very important, besides building the infrastructure is the existence of qualified and capable human capacity. It is about time that the Bulgarian administrations optimizes the work processes and become knowledgeable and utilize effectively the achievements of the information and communication technologies.

The Government's Legislative Program

Veliko Dimitrov

Earlier this week the Council of Ministers announced its legislative plans for the first six months of this year. Naturally the question, which everybody is interested in, is whether anything will change for the better, i.e. whether or not the government is willing to implement any of the long awaited reforms. Since the specific texts of the legislation is not available yet and the entire information consist of a list of legislative intentions, the conclusions about that which probably will happen could be made only in one direction: changes in what areas foresee the Council of Ministers, or which is almost the same, where it considers that there are no problems, and respectively there is no need to initiate any changes.

The following table represents briefly most of the areas where changes will be considered in the existing policies.

Table 1 – Systematic representation of expected legislative initiative of the government according to areas and expected motives for the first three months of the year.

Area	Assumed reason
January	
1. Ecology	Further harmonization and adjustment to the EC norms of the national legislation
2. Competitive Law	Further harmonization and adjustment to the EC norms of the national legislation
3. Air Transportation**	Further harmonization and adjustment to the EC norms of the national legislation
4. Foods and forage **	Further harmonization and adjustment to the EC norms of the national legislation
5. Radio and Television	???
February	
6. Waste	Further harmonization and adjustment to the EC norms of the national legislation
7. Energy efficiency	Further harmonization and adjustment to the EC norms of the national legislation
8. Statistics, meetings and manifestations, damage caused by the state	Probably not mandated by EC norms, the direction of the specific changes is not clear yet
March	
9. Extradition and European arrest order	Further harmonization and adjustment to the EC norms of the national legislation
10. Measurements	Further harmonization and adjustment to the EC norms of the national legislation
11. Obligations towards the International Fund for compensations, caused by pollution with oil	International obligations

12. Student Loans	National issue, to pass a Law on Student Loans
13. Assistance to agriculture and agricultural regions	European norms probably amended with specific national character
14. Explosives and pyrotechnical materials	Further harmonization and adjustment to the EC norms of the national legislation
15. Telecommunications	Harmonization is achieved, the changes are probably related either with precision of the EU norms or introduction of additional regulations on the market (the idea of removing such regulations have never been shared by the government, respectively it is not very likely that the changes will be in that direction)
16. Mineral Wealth	???

* We have excluded legislation for ratification of international and intergovernmental agreements, memoranda, etc.

** According to the last report about the progress of Bulgaria on the accompanying measures after joining the EU, in the area of civil aviation we are behind with respect to application of the rules of the Union and the United Aviation Authority (UAA). According to the same report, in the area of food safety a review is foreseen of the accepted transitional measures, it is highly probable that they must be adjusted as well.

Specifically for January, since it is already ending, we have to note that not a single one of the above mentioned proposed bills have been put to the Parliament at this time[2]. Specifically we are talking about the following measures:

- A bill about the responsibilities for pollution and cleaning of environmental damage;
- A bill about amendments of the Law for protection of competition;
- A bill about amendments to the Law on Civic Aviation;
- A bill about amendments to the Law on Foodstuff;
- A bill for amendments to the Law on Forages;
- A bill for amendments to the Law on Radio and Television.

During the same period there are bills entered in the Parliament by the Council of Ministers (CM), which however are different from those mentioned above in the legislative program. Respectively, on the first place we have to mention that CM does not execute activities which it has promised to execute and actually alone defined.

On the second place, in case that our expectation that the basis for the proposed bills is correct, than we have to draw the conclusion that CM to some degree acts as a local administration to EC. If we take into account the fact that the largest part of bills, proposed by the CM are passed by the parliament, while the proposals of the opposition are mainly rejected, than the parliament is acting as a registration-administrative structure of the CM, which itself is acting as a EC administration.

What we should not miss is that the government apparently has no intention to reform pensions, healthcare and education systems, since the related to these sectors bills are not among those proposed for amending. In that respect we could hope that the initiative would come from the opposition or MP's from the ruling coalition, which however without the support of the CM is almost 100 percent bound to fail.

One other very troublesome question – according to the last amendments of the Bill on Legislative Acts (BLA – into effect since 1st of January 2008), the motives which accompany the proposed bills must contain:

- The reasons which require to pass the bill;
- The goals set;
- Financial and other means required to apply the new regulation;

[2] You could check this at the address: http://www.parliament.bg/?page=app&lng=bg&aid=4

- Expected results from the application, including financial, if there are any:
- Analysis of compliance with of the EU laws.

Also according to the BLA a proposal for a bill, which is not accompanied by motives, which correspond to the five criteria simultaneously, will not be allowed for discussion by the competent body, i.e. the Parliament? A review of all proposed bills, up until now, none complies with all of the above criteria. Is it necessary to reject reviewing them as a result of none compliance with the requirements of the law is a question that needs an answer.

How healthcare is financed in Europe?

Zornitsa Manolova, Intern at IME

Around the World there are three basic types of healthcare systems – model "Beverage", where healthcare is assured for all people, regardless of their financial status; model "Bismarck", based on insurance with health funds and model "Kennedy" where healthcare is provided by the private sector. The healthcare in Europe is characterized by the first two models, while the last model is used mainly in Asia and the USA.

An important characteristic of the "Bismarck" model is the existence of one or many healthcare funds, which are independent, from organizational point of view, from the hospitals and medical establishments, which provide healthcare services. This model is characteristic for Germany, France, Belgium and the countries from Eastern Europe. As a whole the "Bismarck" system has more supporters in Europe. Bulgaria also selected this model of healthcare during the reform of the system in 1998 and the establishment of the National Healthcare Fund, which manages the funds collected from the health contributions.

In the "Beverage" system financing and assurance are implemented by one structure, i.e. the process of financing and delivery of the services is not divided and is completely or partially connected with one organization. The largest such system is The National Healthcare System in Great Britain. The system is applied also in the Scandinavian countries, Italy, Spain, Portugal and Greece.

The healthcare system in Bulgaria is characterized by serious problems, which result from the lack of competition in the sector, the monopolistic position of the National Healthcare Fund in determining the financing for healthcare services, the lack of free negotiation between the patient, the financing institution (represented by National Healthcare Fund) and the medical establishments. The results are the irrational distribution of financial resources, different prices for treatment of similar illnesses, accumulation of debts with medication and medical suppliers, as a result of uncompensated costs for medical services. These problems could be resolved through reforms of the sector and correction of the weak points in the existing system.

The European Experience

During the last few years we are witnessing an accelerated expansion of the volume of the medical services offered in Europe, which corresponds to the increased share of the GNP spend on healthcare in the countries. The reason is the higher costs for new services and the trend of aging of the population, which means higher costs for healthcare for the elderly. Simultaneously the share of the private sector in financing of the system is increased.

In the countries of Eastern Europe and Greece the share of public spending for healthcare is relatively smaller than that in the countries of Central and Western Europe. The later is due to the less developed healthcare system, as well as the lower prosperity of the economies of these countries.

In Europe we could observe several different methods for financing of the health system. Great Britain applies financing through the tax system. In Ireland this system is also used, but it is combined with element of private health insurance.

In Denmark and Sweden the financing of the healthcare system is through the local taxes, combined with management of the healthcare providers by the local municipalities. In Denmark the main mechanism for distribution of resources, when financing the hospitals, is implemented through the national budget. Negotiations take place once a year between the Ministry of Public Health, the Ministry of finance, and the regional and local councils, represented by their associations.

Another method for financing the healthcare is through systems for social health insurance. It could be done by the employer and the employee through a variety of non competing autonomous schemes for insurance, as it is in France, or with competing funds as it is in Germany and Holland. The financing of the hospitals in these states is implemented in several ways. In France there are three types of hospitals: state, private non profit and private profit making. The state hospitals there are autonomous and manage their own budget within a preset limit of their costs. Such policy helps reducing the regional differences in the country. The private non profit hospitals are usually owned by foundations, religious organizations, or mutual insurance associations. The private profit making hospitals basically specialize in specific areas and usually have a specified size of expenses. When there is an overrun in the price lists of the services provided the prices are reduced.

In Germany they use the method of “double financing”, i.e. the capital costs are covered by the local government, while the operational cost – by the health funds.

In 2006 Holland reformed its health system by introducing mandatory insurance in private funds. The aim of the reform is to give more choices to the users and to introduce competition in the system, which will lead to greater efficiency of the funds spend.

In Switzerland are used systems for health insurance. In this model all citizens pay mandatory health insurance. The insurance companies compete between themselves to provide various packages of services. The insured people could choose freely between the private funds. The funds pay a specific daily price to the hospitals and negotiate directly with them.

The conclusion is that more and more countries in Europe give the right to their citizens to select by themselves how and where to take insurance in order to get the required medical services. This is so, because the systems which apply private insurance respond to the highest degree to the needs and abilities of the patients and lead to more effective use of the resources in the system due to competition and free negotiation. It is about time for Bulgaria to follow the good practices in Europe and the World in the functioning of the healthcare system.

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